Statement by Governor - First Bi-monthly Monetary Policy, 2019-20, April 4, 2019

The Monetary Policy Committee (MPC) reviewed macroeconomic developments and the outlook over the course of the past two days, *i.e.*, April 2 and 3, 2019 and in its meeting today, it voted by a 4/2 majority to reduce the policy repo rate by 25 basis points, and to maintain a neutral stance of monetary policy by a 5/1 majority. I thank the MPC members for bringing to the discussions their experience and erudition. I also wish to express my appreciation for our teams in the Reserve Bank for their hard work in providing high quality inputs for the MPC's deliberations.

2. I would now like to set out the main global and domestic developments that the MPC evaluated while formulating its decision. It noted that there is a further loss of pace in global economic activity since it last met in February 2019. Moreover, the slowdown appears to be synchronised across advanced economies and some major emerging market economies as well. This assessment is also reflected in the monetary policy stances of their Central Banks, which have either eased or paused. Inflation remains low in major advanced and emerging economies, although crude oil prices have risen on production cuts by major producers and supply disruptions among some exporters. As regards financial markets, equity markets have generally rallied, bond yields have eased and in some advanced economies, they have slipped into negative territory. In currency markets, the US dollar has traded with an appreciating bias, while emerging market currencies have softened.

3. Turning to domestic developments, the MPC observed that the Central Statistics Office (CSO) has pegged India's real gross domestic product (GDP) growth at 7.0 per cent in 2018-19, revised down from 7.2

per cent in its first advance estimates. More recent high frequency indicators point to manufacturing growth slowing down, while investment demand is subdued. Credit flows to micro and small as well as medium industries remains muted, though they somewhat improved somewhat for large industries. Capacity utilisation (CU) in the manufacturing sector is running above its long-term average. There is also some improvement in business sentiment. High frequency indicators of the services sector such as sales of commercial vehicles and freight traffic indicate moderation in activity.

4. The MPC also noted that CPI inflation rose to 2.6 per cent in February 2019 after four months of continuous decline. The upturn reflected an increase in prices of items excluding food and fuel and weaker momentum of deflation in the food group. Households' inflation expectations declined by 40 basis points each for the three months ahead and for the one year ahead horizons. Manufacturing firms reported reduction in input price pressures.

5. On India' external front, export growth remained weak in January and February 2019 while imports, especially non-oil non-gold imports, declined. The trade deficit narrowed in February 2019 to its lowest level in 17 months. Net FDI inflows were strong while foreign portfolio investors turned net buyers in the domestic capital market in Q4:2018-19. India's foreign exchange reserves were at US$ 412.9 billion on March 31, 2019.

6. Taking into account these developments and looking ahead, the MPC revised the path of CPI inflation downwards to 2.4 per cent in Q4:2018-19, 2.9-3.0 per cent in H1:2019-20 and 3.5-3.8 per cent in H2:2019-20, with risks broadly balanced. GDP growth for 2019-20 is

projected at 7.2 per cent: 6.8-7.1 per cent in H1:2019-20 and 7.3-7.4 per cent in H2, with risks evenly balanced.

7. Beyond the near term, the MPC assessed that the short-term outlook for food and fuel inflation remains benign, although there is some uncertainty around the prospects for the monsoon, and seasonal reversals in the prices of some items. The outlook for oil prices continues to be hazy, both on the upside and the downside. Inflation excluding food and fuel has remained elevated, but has shown some moderation compared to the first half of 2018-19. Financial markets remain volatile. The fiscal situation at the general government level requires careful monitoring. Overall, the output gap remains negative and, therefore, strengthening domestic growth impulses by spurring private investment assumes priority.

8. To summarise, global growth is slowing down, and this is also reflected in three successive downward revisions made by the IMF in its projection of global growth for 2019. Domestic GDP growth is also estimated to slow in 2018-19, with high frequency indicators suggesting slackening of urban and rural demand as well as investment activity. While bank credit is growing at 14.3 per cent, it is not broad-based. Bank credit to micro and small industries, which are critical to employment and exports, was flat (0.6 per cent) as also credit to medium industries (0.7 per cent). Growth projections for 2019-20 have accordingly been revised downwards from 7.4 per cent to 7.2 per cent.

9. Retail inflation rose to 2.6 per cent in February 2019 from a low of 2.0 per cent in January; however, the upturn has turned out to be 30-40 basis points lower than our projections made in the February policy. Accordingly, inflation projections have been recalibrated. As per our

current projections, headline CPI inflation is projected at 3.8 per cent in Q4:2019-20.

10. Against this backdrop, the MPC voted to reduce the policy rate by 25 basis points while maintaining a neutral stance.

11. Going forward, the RBI will continue to watch the evolving macroeconomic situation and shall act in time and act decisively. With the inflation outlook remaining benign, the RBI will address the challenges to sustained growth of the Indian economy, while ensuring price stability on an enduring basis in pursuance of its mandate in the RBI Act.

12. I would now like to address some developmental and regulatory policies which we have announced today.

i) **Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards**

   We have allowed an additional 2.0 percent of SLR to be reckoned as Level 1 High Quality Liquid Assets (HQLAs) for the purpose of computing the LCR of banks. While this move will harmonise the liquidity requirements of banks with the LCR, it will also immediately release additional liquidity for lending by the banks.

ii) **Committee on the Development of Housing Finance Securitisation Market**

   We are aware that well-functioning securitisation markets can enable better management of credit and liquidity risks in the balance-sheets of banks as well as non-bank mortgage originators and, in turn, would help lower the costs of mortgage finance in the economy. We have decided to constitute a Committee that will assess the state of housing finance securitisation markets in India; study the best international practices as well as lessons learnt from the global financial crisis; and propose measures to further develop these markets in India.

iii) **Task Force on the Development of Secondary Market for Corporate Loans**

At present, the secondary market for corporate loans in India is dominated by transactions of banks in non-performing assets and is constrained by sparse information on pricing and recovery rates. Recognising the benefits of an *active* secondary market in loans, the Reserve Bank will set up a Task Force to study the relevant aspects, including best international practices and to propose measures for developing a thriving secondary market for corporate loans in India.

iv) **Issue of Instructions on External Benchmark**

As announced in the 'Statement on Developmental and Regulatory Policies' of December 05, 2018, it was proposed that all new floating rate personal or retail loans (housing, auto, etc.) and floating rate loans to Micro and Small Enterprises extended by banks from April 1, 2019 shall be benchmarked to the external benchmarks, viz., the RBI Repo Rate or any other benchmark market interest rate published by the Financial Benchmark India Private Ltd. (FBIL).

Taking into account the feedback received during discussions held with stakeholders on issues such as (i) management of interest rate risk by banks from fixed interest rate linked liabilities against floating interest rate linked assets and the related difficulties, and

(ii) the lead time required for IT system upgradation, it has been decided to hold further consultations with stakeholders and work out an effective mechanism for transmission of rates. In the meantime, we have taken several measures to enable better management of interest rate risk by banks, for instance, by allowing non-residents to participate in the Rupee interest rate swap market.

v) **Countercyclical Capital Buffer**

The framework on countercyclical capital buffer (CCCB) was put in place by the Reserve Bank in terms of guidelines issued on February 5, 2015 wherein it was advised that the CCCB would be activated as and when the circumstances warranted, and that the decision would normally be pre-announced. Based on the review and empirical testing of CCCB indicators, it has been decided that it is not necessary to activate CCCB at this point in time.

vi) **Permitting G-sec trading through International Central Securities Depositories (ICSDs)**

As a step in the continuing process of broadening the investor base for Government securities, the Reserve Bank, in consultation with the Government and SEBI, shall open a separate channel for international investors by allowing them to invest through International Central Securities Depositories (ICSDs).

vii) **Licensing of Non-Banking Financial Companies (NBFCs) as Authorised Dealer Category II**

Increasingly, a large segment of resident Indians are availing foreign exchange facilities for the purpose of overseas education, medical treatment abroad, business travel, private visits (non-trade current account transactions) which are presently undertaken only through Authorised Dealers Category I, II, III and the full-fledged money changers.

With a view to improve the ease of undertaking forex transactions by increasing the last-mile touch points of regulated entities to sell foreign exchange for non-trade current account transactions, it has been decided that non-deposit taking systemically important Non-Banking Financial Companies (NBFCs-NDSI) in the category of Investment & Credit Companies (ICCs) will be made eligible to apply for grant of Authorised Dealer Category II licence. Detailed instructions in this regard shall be issued by the end of April 2019.

viii) **Benchmarking India's Payment Systems**

Benchmarking India's Payments Systems is necessary to gauge India's progress *vis-à-vis* payment systems and instruments in major countries and give further impetus to the planned efforts for deepening the digitisation of payments. A report containing the findings of such an exercise will be placed on the RBI website by the end of May 2019.

ix) **Framework for Harmonizing Turn Around Time for the Resolution of Customer Complaints and Compensation**

Currently, different payment systems have varied mechanisms for addressing customer grievances and the time for resolving customer complaints are not uniform. In order to have a prompt and efficient complaint redress framework for all electronic payment systems, it is necessary to have harmonisation of the response time for complaint management and for other payment transactions, such as the reversal of a failed transaction across various payment systems. To this end, the, RBI proposes to come out with a framework on TAT for resolution of customer complaints and compensation framework across all authorised payment systems.

x) **Convergence of Priority Sector Lending (PSL) guidelines for housing loans between Scheduled Commercial Banks (SCBs) and Regional Rural Banks (RRBs) and Small Finance Banks (SFBs)**

The housing loan limits for eligibility under Priority Sector Lending were revised during June 2018, for Scheduled Commercial Banks (excluding Regional Rural Banks and Small Finance Banks). It has been decided to extend the revised limits to Regional Rural Banks and Small Finance Banks also to provide level-playing field to these banks.

xi) **Extension of NBFC Ombudsman Scheme to cover Non-Deposit taking Non-Banking Financial Companies (NBFCs)**

In pursuit of strengthening the grievance redressal mechanism for bank customers, the Reserve Bank is will widen the existing NBFC-Ombudsman scheme, introduced on February 2018, to cover the customers of non-deposit taking NBFCs registered with RBI and having asset size of ₹ 100 crore and above.